

Report  
of the  
Examination of  
Wisconsin Municipal Mutual Insurance Company  
Madison, Wisconsin  
As of December 31, 2003

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

**Jim Doyle**, Governor  
**Jorge Gomez**, Commissioner

**Wisconsin.gov**

November 9, 2004

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Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of  
the affairs and financial condition of:

WISCONSIN MUNICIPAL MUTUAL INSURANCE COMPANY  
Madison, WI

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of Wisconsin Municipal Mutual Insurance Company (WMMIC or the company) was conducted in 1999 as of December 31, 1998. The current examination covered the intervening period ending December 31, 2003, and included a review of such 2004 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## II. HISTORY AND PLAN OF OPERATION

In 1987, the company was incorporated under s. 66.30, Wis. Stat., as a “joint powers authority” rather than under the Wisconsin insurance statutes. The purpose of the entity is to provide automobile liability and general liability insurance at a reasonable cost to its members. WMMIC began offering worker’s compensation insurance coverage in 2000. All of the company’s members are counties and cities within the state of Wisconsin and the company is licensed only in Wisconsin.

In Wisconsin, municipalities have limited exposure to large general liability and automobile liability claims due to a tort cap of \$50,000 on general liability and \$250,000 on automobile liability pursuant to ss. 893.80 (3) and 345.05 (4), Wis. Stat. However, no tort cap is effective for miscellaneous liability actions, such as those brought in federal court.

The following table is a summary of the net insurance premiums written by the company in 2003. The growth of the company is discussed in the “Financial Data” section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Worker’s compensation	\$ 422,799	\$ 0	\$422,799	\$ 0
Other liability - occurrence	2,233,543		323,353	1,910,190
Commercial auto liability	<u>524,319</u>	<u>      </u>	<u>75,848</u>	<u>448,471</u>
Total All Lines	<u>\$3,180,661</u>	<u>\$ 0</u>	<u>\$822,000</u>	<u>\$2,358,661</u>

### Capital Structure

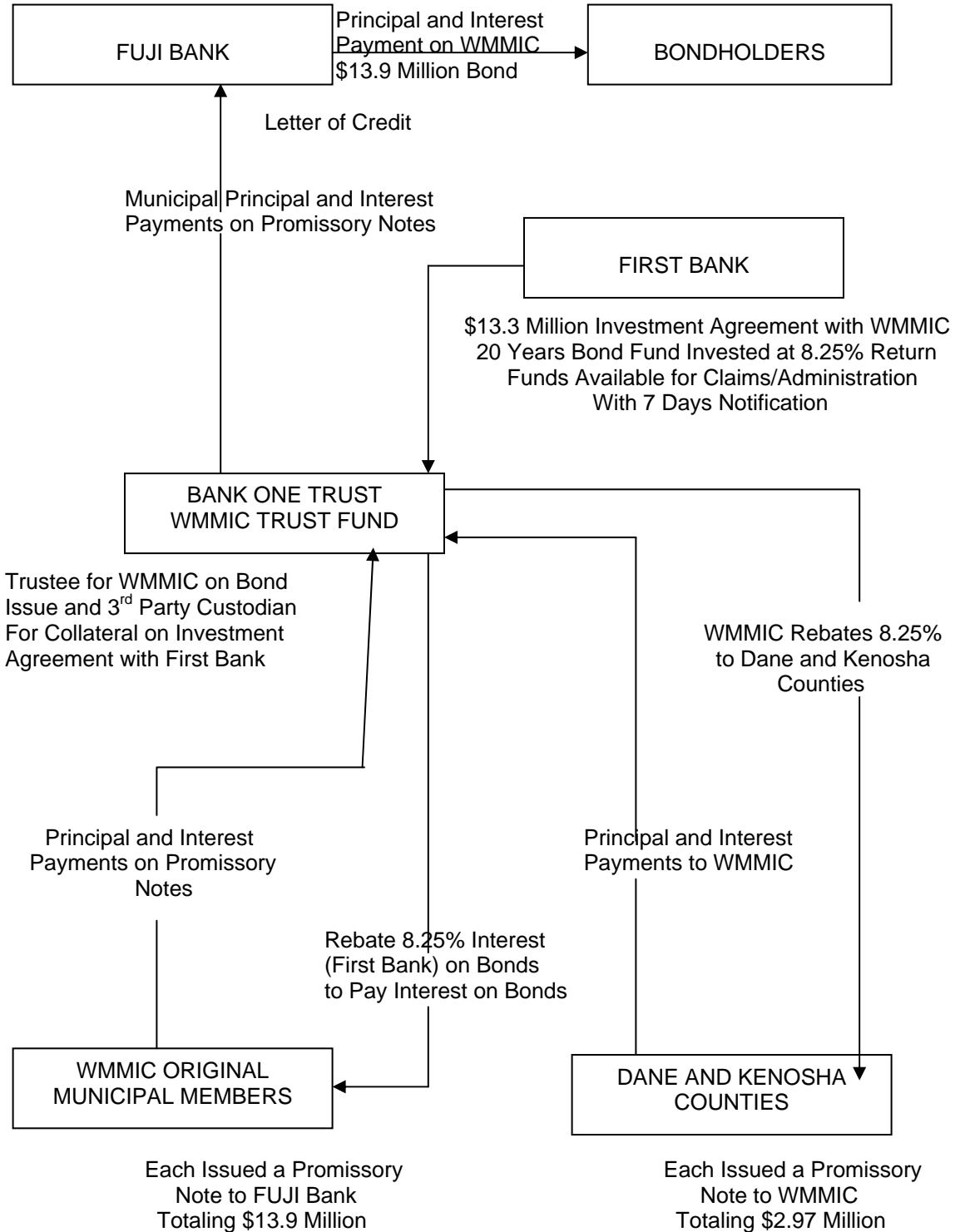
Initial capitalization of \$13.3 million was obtained through a public offering of tax-exempt serial revenue bonds. In order to count the bonds as surplus and to have an assured revenue source with respect to payment of principal and interest, the following occurred:

1. A letter of credit was obtained to assure payment of the bond obligations.
2. Each member policyholder issued a promissory note to the bank as collateral for the letter of credit, which in total equaled the principal and interest payments.

Payment of the principal and interest was funded by member payments on the promissory notes and dividends from the company. In the event that funding requirements were not met to cover the bond obligations, the letter of credit could have been called. The following chart details the funding arrangements for the initial capitalization of the company.

# WMMIC CAPITALIZATION

## \$13.9 MILLION BOND ISSUE AND NEW MEMBER CONTRIBUTION FLOW CHART



The letter of credit was renewed in 1996 to match the outstanding debt for the years 1997 through 2007. The members, through the 10-year call option of the bonds, reduced the outstanding debt from the initial capitalization to \$1,315,000 when the letter of credit was renewed. At the time of the examination, the outstanding debt was \$1,025,000.

In an order issued by the Commissioner, the company is exempt from several provisions of the statutes and insurance administrative code. Pursuant to s. 611.23, Wis. Stat., the Commissioner has waived the following statutes:

- Sections 611.74 and 181.50, Wis. Stat. Section 8.01 (e) of the articles of incorporation is more restrictive regarding dissolution.
- Section 611.32 (2), Wis. Stat., but s. 66.066, Wis. Stat., is applicable to bonds issued.
- Sections 620.22 and 620.23, Wis. Stat., but s. 66.04, Wis. Stat., is applicable regarding investment limitations.
- Sections 645.72 (4) (e) and 611.74 (4), Wis. Stat. Section 8.02 of the articles of incorporation, which provides for the distribution of assets in rehabilitation or liquidation, is applicable.

The order allows the company to exclude its revenue bond obligation from the initial capitalization as a liability on the balance sheet, due to the bonds being supported by a letter of credit. The order also allows the company to accept general obligation securities issued by new members as capital contributions. However, such securities shall not be counted towards compulsory and security surplus calculations. Except for capital contributions from new members, the company shall not invest in any securities issued by member municipalities at any time.

WMMIC has established an investment program, which matches its obligations with its earnings. Because of the Tax Reform Act of 1986, the bonds from the initial capitalization could be subject to federal income taxation retroactively if the company engages in positive arbitrage and earns more on its investment funds than they pay on the bond obligation. Thus, the company can earn no more than 8.25% interest on the invested assets from the initial capitalization.

A financially sound and actuarially determined dividend distribution formula was developed for both the "Capital" and the "Operating" dividend. The capital dividend distributes the investment earnings on "Gross paid in and contributed surplus" to members.

The operating dividend distributes a portion of the “net income” based on a formula that considers the individual member’s contribution to net income and their equity position in the company. The two components are the equity/loss position of each member and the premium/loss experience of each member. This dividend has a seven-year maturity requirement. For example, fund-year 1996 would be distributed in 2004 based on a 95% confidence factor as determined by the actuary.

### **Membership Structure**

The company was organized due to significant premium increases being experienced by municipalities and the inability of certain municipalities to obtain insurance in the mid-1980s. The company provides casualty and liability insurance to its members with a \$5 million limit per claim. Each municipality has a self-insured retention (SIR) limit and an annual aggregate retention limit, which is based on an actuarial valuation. Each member is obligated to fund losses until the SIR limit is reached. A list of the current members, as of the date of this examination, and their single and aggregate retentions for casualty and liability claims is as follows:

<b>Member</b>	<b>Single</b>	<b>Aggregate</b>
Brown County	\$100,000	\$ 250,000
Chippewa County	75,000	250,000
City of Eau Claire	200,000	400,000
City of Madison	300,000	1,800,000
Dane County	250,000	1,500,000
Dodge County	75,000	250,000
Eau Claire County	100,000	250,000
Kenosha County	100,000	500,000
LaCrosse County	75,000	300,000
Manitowoc County	125,000	400,000
Marathon County	400,000	400,000
Outagamie County	150,000	500,000
St. Croix County	150,000	500,000
Waukesha County	250,000	750,000

New members joining the company contribute equity to the company based on an actuarially determined risk level that each member brings to the company. New members’ contributions may either be distributed back to the existing members based on their equity percentage, or the contributions can be used to increase surplus. To date, all new member equity has been used to increase surplus. The company has provisions for the use of agents to obtain business, but all current members place their business directly, without the use of agents.



### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of seven members. Five of the directors are elected to serve three-year staggered terms, while two at large directors are elected annually to serve one-year terms. Officers are elected at the board's annual meeting. The board members currently are not compensated for serving on the board. However, they do receive reimbursement for meals and lodging plus \$.375 per mile for automobile expenses.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Dean Brasser Madison, WI	Comptroller City of Madison	2005
Edward Czaja Greenville, WI	Finance Director Outagamie County	2006
Frank Draxler Eau Claire, WI	Purchasing Agent Eau Claire County	2005
Nicholas Evgenides Green Bay, WI	Risk Manager Brown County	2005
J. Dale Peters Eau Claire, WI	Director of Human Resources, Risk Mgr City of Eau Claire	2007
Laura Stauffer Waukesha, WI	Risk Manager Waukesha County	2005
Bernard Vash Kenosha, WI	Assistant Corporate Counsel Kenosha County	2006

#### Officers of the Company

The officers serving as of December 31, 2003, are as follows:

Name	Office	2003 Compensation
Peter Boss*	Executive Director	\$97,012
Laura Stauffer	President & Chairman	0
Bernard Vash	V.P. & Vice Chairman	0
Norman Cummings	Treasurer	0
Carole Charles	Secretary	0

\* Mr. Boss retired in September 2004; Mr. Kevin Murphy has replaced Mr. Boss effective September 15, 2004, with an annual compensation of \$120,000.

## **Committees of the Board**

The company's bylaws allow for the formation of certain committees by the board of directors. The committee members at the time of the examination are listed below:

### **Finance Committee**

Edward Czaja, Chair  
Norman Cummings  
Garland Lichtenburg  
Dean Brasser  
William Shepherd  
Howard Ludwigson  
Kristi Kordus

### **Underwriting Committee**

J. Dale Peters, Chair  
Laura Stauffer  
Frank Draxler  
Carol Charles  
Barbara Wegner  
Daniel Fischer  
Charlene Peterson  
Rachel Rubin

### **Claims Committee**

Bernard Vash, Chair  
Nicolas Evgenides  
John Corey  
Connie Fisher  
Kevin Houlihan  
Mary Maly  
Chuck Hicklin

### **Nominating Committee**

Edward Czaja, Chair  
Barbara Wegner  
Garland Lichenburg

#### **IV. AFFILIATED COMPANIES**

WMMIC is not a member of a holding company system. It is a policyholder owned mutual company, with no affiliates.

## V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

### Nonaffiliated Ceding Contracts

1. Type: Excess of Loss  
Reinsurer: Government Entities Mutual, Inc.  
Scope: Casualty Excess of Loss: General Liability, Auto Liability, Public Official Liability, and Employee Benefits Liability.  
Retention: \$1,000,000 per Occurrence/Claim (\$2,500,000 for Transit). No Aggregate Limit applicable.  
Coverage: \$4,000,000 per Occurrence or Per Claim. No Aggregate Limit applicable.  
Premium: \$399,201  
Effective date: January 1, 2003  
Termination: January 1, 2004
2. Type: Excess of Loss  
Reinsurer: Safety National Casualty Corporation  
Scope: Worker's Compensation  
Retention: Madison City: \$500,000 Per Occurrence. Other Members: \$250,000 per Occurrence.  
Coverage: Excess of \$500,000 for the City of Madison, and \$250,000 for the Other Members.  
Statutory Limit of Indemnity per Occurrence:  
Employer's Liability each Accident: \$1,000,000; E.L. Disease each Employee: \$1,000,000; E.L. Disease Policy: \$1,000,000.  
Employer's Liability Maximum Limit of Indemnity per Occurrence: \$1,000,000  
USL&H: \$600,000.  
Premium: \$424,881(City of Madison: \$0.0679, Other Members: \$0.0765 per \$100 of Payroll).  
Effective date: January 1, 2003 (City of Madison: 05/1/2003 and St. Croix County: 03/01/2003).  
Termination: January 1, 2004

During 2003 WMMIC assumed excess of loss coverage on automobile liability business from Transit Mutual Insurance Company. Transit Mutual retained the first \$1.5 million of risk, while WMMIC assumed the next \$1.0 million and ceded the remaining \$4.0 million to Government Entities Mutual, Inc. The Transit Mutual agreement is no longer in effect in 2004.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

**Wisconsin Municipal Mutual Insurance Company**  
**Assets**  
**As of December 31, 2003**

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$19,308,650	\$0	\$19,308,650
Cash	576,736		576,736
Short-term investments	5,092,721		5,092,721
Other invested assets	13,822,594		13,822,594
Investment income due and accrued	264,328		264,328
Write-ins for other than invested assets:	<u>3,942,154</u>	<u>0</u>	<u>3,942,154</u>
Total Assets	<u>\$43,007,183</u>	<u>\$0</u>	<u>\$43,007,183</u>

**Wisconsin Municipal Mutual Insurance Company**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2003**

Losses		\$ 5,632,514
Loss adjustment expenses		1,174,736
Other expenses (excluding taxes, licenses, and fees)		117,582
Unearned premiums		
Dividends declared and unpaid:		
Policyholders		2,601,045
Write-ins for liabilities:		
Amount withheld for member SIR account		<u>3,942,154</u>
Total Liabilities		13,468,031
Gross paid in and contributed surplus	\$19,018,934	
Unassigned funds (surplus)	<u>10,520,218</u>	
Surplus as Regards Policyholders		<u>29,539,152</u>
Total Liabilities and Surplus		<u>\$43,007,183</u>

**Wisconsin Municipal Mutual Insurance Company**  
**Summary of Operations**  
**For the Year 2003**

**Underwriting Income**

Premiums earned		\$ 2,358,661
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Deductions:

Losses incurred	\$1,974,678	
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Loss expenses incurred	354,121	
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Other underwriting expenses incurred	713,700	
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Total underwriting deductions		<u>3,042,499</u>
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Net underwriting gain or (loss)		(683,838)
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**Investment Income**

Net investment income earned	<u>1,851,360</u>	
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Net investment gain or (loss)		1,851,360
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**Other Income**

Write-ins for miscellaneous income:

Misc. Income	<u>78,006</u>	
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Total other income		78,006
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Net income (loss) before dividends to policyholders		1,245,528
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Dividends to policyholders		<u>3,033,736</u>
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Net (Loss)		<u><u>\$(1,788,208)</u></u>
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**Wisconsin Municipal Mutual Insurance Company**  
**Cash Flow**  
**For the Year 2003**

Premiums collected net of reinsurance		\$2,358,661
Net investment income		2,080,165
Miscellaneous income		<u>78,006</u>
Total		4,516,832
Benefit and loss-related payments	\$ 14,624	
Commissions, expenses paid, and aggregate write-ins for deductions	604,043	
Dividends paid to policyholders	<u>3,066,928</u>	
Total deductions		<u>3,685,595</u>
Net cash from operations		831,237
Proceeds from investments sold, matured, or repaid:		
Bonds	<u>\$8,631,927</u>	
Total investment proceeds	8,631,927	
Cost of investments acquired (long-term only):		
Bonds	4,640,787	
Other invested assets	<u>500,000</u>	
Total investments acquired	<u>5,140,787</u>	
Net cash from investments		3,491,140
Cash from financing and miscellaneous sources:		
Capital and paid in surplus less treasury stock	<u>273,002</u>	
Net cash from financing and miscellaneous sources		<u>273,002</u>
<b>Reconciliation</b>		
Net change in cash and short-term investments		4,595,379
Cash and short-term investments, December 31, 2002		<u>1,074,078</u>
Cash and short-term investments, December 31, 2003		<u>\$5,669,457</u>

**Wisconsin Municipal Mutual Insurance Company  
Compulsory and Security Surplus Calculation  
December 31, 2003**

Assets		\$43,007,183
Less liabilities		<u>13,468,031</u>
Adjusted surplus		29,539,152
Annual premium:		
Lines other than accident and health	\$2,358,661	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million)		<u>2,000,000</u>
Compulsory surplus excess (or deficit)		<u>\$27,539,152</u>
Adjusted surplus (from above)		\$29,539,152
Security surplus: (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million, with a minimum factor of 110%)		<u>2,800,000</u>
Security surplus excess (or deficit)		<u>\$26,739,152</u>

**Wisconsin Municipal Mutual Insurance Company  
Reconciliation and Analysis of Surplus  
For the Five-year Period Ending December 31, 2003**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
Surplus, beginning of year	\$31,054,358	\$31,592,261	\$28,198,568	\$26,596,072	\$27,003,956
Net income	(1,788,208)	(537,903)	1,136,694	1,949,239	373,858
Change in nonadmitted assets				34,257	34,258
Cumulative effect of changes in accounting principles			1,320,000	(381,000)	(816,000)
Surplus adjustments:					
Paid in	<u>273,002</u>	<u>          </u>	<u>937,000</u>	<u>          </u>	<u>          </u>
Surplus, end of year	<u>\$29,539,152</u>	<u>\$31,054,358</u>	<u>\$31,592,261</u>	<u>\$28,198,568</u>	<u>\$26,596,072</u>

**Wisconsin Municipal Mutual Insurance Company  
Insurance Regulatory Information System  
For the Five-Year Period Ending December 31, 2003**

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	<b>Ratio</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
#1	Gross Premium to Surplus	11%	8%	7%	8%	8%
#2	Net Premium to Surplus	8	6	6	7	7
#3	Change in Net Writings	21	0	0	5	(1)
#4	Surplus Aid to Surplus	0	0	0	0	0
#5	Two-Year Overall Operating Ratio	154*	85	21	39	53
#6	Investment Yield	4.9	5.7	6.8	6.8	6.2
#7	Change in Surplus	(5)	(2)	12	6	(2)
#8	Liabilities to Liquid Assets	53	46	25	28	30
#9	Agents' Balances to Surplus	0	0	0	0	0
#10	One-Year Reserve Development to Surplus	4	2	(2)	(4)	(2)
#11	Two-Year Reserve Development to Surplus	6	0	(6)	(4)	(5)
#12	Estimated Current Reserve Deficiency to Surplus	0	0	0	0	0

Ratio No. 5 measures the company's profitability over the previous two-year period.

The company has been strengthening its reserves over the last two years due to several specific claims, resulting in this exceptional IRIS ratio in 2003.

### Growth of Wisconsin Municipal Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2003	\$43,007,183	\$13,468,031	\$29,539,152	\$(1,788,208)
2002	42,493,659	11,439,301	31,054,358	(537,903)
2001	41,167,591	9,575,330	31,592,261	1,136,694
2000	39,185,624	10,987,056	28,198,568	1,949,239
1999	37,903,389	11,307,317	26,596,072	373,858
1998	36,744,437	9,740,481	27,003,956	1,378,134

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2003	\$3,180,661	\$2,358,661	\$2,358,661	98.7%	27.0%	125.7%
2002	2,558,696	1,943,982	1,943,982	62.4	29.8	92.2
2001	2,303,650	1,950,588	1,950,588	.5	28.0	28.5
2000	2,296,230	1,948,512	1,948,512	(40.9)	35.8	(5.1)
1999	2,069,387	1,854,387	1,854,387	25.1	32.6	57.7
1998	2,042,701	1,869,421	1,869,421	8.2	25.1	33.3

In 2000, loss reserves and loss adjustment expense for years 1988 through 1999 were evaluated by the company's actuary, who recommended a reduction in carried IBNR reserves. This reduction of \$1,671,495 in IBNR reserves for these years resulted in an unusual negative Loss and LAE Ratio. In 2002 and 2003, WMMIC strengthened reserves due to a few specific claims, and paid \$5,816,902 in policyholder dividends resulting in a decrease to surplus. This also caused the two-year overall operating ratio to be exceptional in 2003 as noted above.

### Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus as regards policyholders between that reported by the company and as determined by this examination:

Surplus December 31, 2003, per annual statement			\$29,539,152
	<b>Increase</b>	<b>Decrease</b>	
Losses	<u>\$ 0</u>	<u>(\$2,274,368)</u>	
Net increase or (decrease)	<u>\$ 0</u>	<u>(\$2,274,368)</u>	<u>(2,274,368)</u>
Surplus December 31, 2003, per examination			<u>\$27,264,784</u>

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were seven specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Fidelity Bond—It is again recommended that the company take the measures to ensure that the minimum amount of fidelity insurance is obtained as specified by the NAIC's Examiners Handbook.

Action—Compliance

2. Articles and Bylaws—It is recommended that the BOD meet at the required time as specified in its bylaws, or amend its bylaws to reflect the current needs of the company.

Action—Compliance

3. Articles and Bylaws—It is recommended that the company comply with s. 611.56 (1), Wis. Stat., in regards to committee appointments.

Action—Noncompliance, see comments in the summary of current examination results.

4. Compulsory and Security Surplus—It is recommended that the company comply with the order issued on August 23, 1995, and exclude the appropriate securities from the compulsory and security surplus calculation.

Action—Compliance

5. Loss Reserves—It is recommended that IBNR reserves be reported as IBNR reserves on Schedule P part one summary and not as case reserves.

Action—Compliance

6. Self-Insured Retention Funds—It is recommended that WMMIC account for the SIR funds on future annual statements in the following manner:

- Record outstanding checks as a deduction to the checking account;
- Record WMMIC's portion of the SIR checking account as cash;
- Record the SIR funds held in a fiduciary capacity for others as an aggregate write-in for liabilities;
- Record the SIR assets excluding WMMIC's portion of the checking account as an aggregate write-in for invested assets.
- Summarize in the Notes to the Financial statements what the assets in the SIR trust account consists of in terms of types of assets (i.e., bonds, repurchase agreements, short-term investments, and cash); and
- Obtain a custodian agreement for the assets in the SIR trust account which is in compliance with the NAIC's Examiners Handbook.

Action—Partial compliance, see comments in the summary of current examination results.

7. Short-Term Investments—It is again recommended that the company report money market funds on its filed annual statement in accordance with the Annual Statement Instructions - Property and Casualty by reporting these investments as short-term investments on both the balance sheet and on schedule DA.

Action—Compliance

## **Summary of Current Examination Results**

### **Loss Reserve**

The company's reported loss reserve balance at the end of 2003 was \$5,632,514 of which \$4,074,000 was for three specific claims settlements. Following the settlement of two of these claims (see subsequent events at the end of this section) and an increase in the reserve for the third, this examination determined that the case reserves should have been higher by \$2,274,378. The company had already addressed most of this shortfall by September 30, 2004. An adjustment in the amount of \$2,274,368 is being made increasing the loss reserves and decreasing surplus due to the significant adverse loss reserve development of these three large claims.

### **Articles and Bylaws**

In the prior exam, it was noted that Article 4 of WMMIC's bylaws allows for the establishment of committees of the board of directors. Article 4 also states each such committee shall consist of not less than two board members. This was not in compliance with s. 611.56 (1), Wis. Stat., which states the committees of the board shall consist of three or more directors serving at the pleasure of the board. Furthermore, it was noted that one committee only had one board member assigned to it, which is not in compliance with the company's own bylaws. Examiners determined that WMMIC had not complied with the prior exam recommendation on this subject. It is again recommended that the company comply with s. 611.56 (1), Wis. Stat., in regards to committee appointments and, in addition, amend its bylaws to be consistent with the law.

During the review of WMMIC's Articles and Bylaws, it was noted that there were changes or amendments made to the Articles and Bylaws which were not filed with the Commissioner of Insurance as required by s. 611.12 (4), Wis. Stat. It is recommended that the company comply with s. 611.12 (4), Wis. Stat., and file all Article and Bylaw amendments with the Commissioner within 60 days after adoption.



## Self-Insured Retention Funds

Insured members of WMMIC are liable for claims up to each member's self-insured retention (SIR) limit. WMMIC adjusts and pays all claims incurred by its members regardless of whether they are above or below the member's SIR limit. WMMIC operates a special bank account for monies deposited by the members to pay for these claims. Members are required to replenish monies to the SIR account on a quarterly basis, because WMMIC uses the funds in the SIR account to pay for the member claims that fall below the SIR limit. The funds held in this account consist of the following items:

	2003
Money Market Fund	\$ 9,526
Bonds	3,785,313
Repurchase Agreement (sweep account)	94,328
Checking account (to pay claims)	<u>53,000</u>
Total	<u>\$3,942,167</u>

The outstanding checks written against the checking account in the amount of \$104,042 were not deducted from the SIR checking account balance as recommended in the prior examination. The prior examination of the company also recommended that the company report the members' SIR account balance as an "Aggregate write-in for invested assets" on the company's financial statement. The current examination determined that the company holds these funds on behalf of its members, so reporting the SIR account in the company's invested assets is not appropriate. The examiners agree that it is more appropriate to report the SIR account net (less outstanding checks) under "Aggregate write-in for other than invested assets" with a corresponding amount reported under "Aggregate write-in for liabilities" on the company's financial statements. It is recommended that WMMIC record the SIR assets, excluding WMMIC's portion of the checking account, and net of outstanding checks, as "Aggregate write-in for other than invested assets" with a corresponding amount reported under "Aggregate write-in for liabilities."

## Reinsurance

The examiners noted that WMMIC incorrectly reported premiums from reinsurance assumed as direct business, and failed to report the assumed reinsurance from Transit Mutual

Insurance Company on Schedule F Part 1. Transit Mutual retained the first \$1.5 million of risk, while WMMIC assumed the next \$1.0 million and ceded the remaining \$4.0 million to Government Entities Mutual, Inc., (GEM) and properly included this ceded business on Schedule F Part 3.

WMMIC reported on Schedule F Part 3 that GEM was an authorized reinsurer. It was determined during the examination that GEM is not an authorized reinsurer.

The company reported a \$73,459 ceded reinsurance premium payable under "Other expenses" on their financial statement, rather than as "Ceded reinsurance premiums payable." It is recommended that the company properly report reinsurer account balances and information on its annual statement in accordance with NAIC Annual Statement Instructions – Property and Casualty.

### **Cash & Investments**

The majority of the company's investments are administered by unrelated investment advisors and held by custodians. Examiners noted that one of the advisors purchased bonds in 2003 which did not comply with the company's investment policy, nor was the investment policy referenced in the advisor's agreement. A bank account exceeded the policy limits on bank account balances. An equity investment in a reinsurance company, which was approved by the company's board of directors, did not comply with the policy. It is recommended that the company comply with the existing Investment Policy or update and amend the policy to accurately reflect the current recommendations of the board of directors, and that a responsible officer review the investments for compliance with the policy.

During the cash disbursement testing portion of the exam, it was noted that the company did not always follow the board of directors' policy regarding check signatures, authority limits, and dual signature requirements. Several checks did not have the required second signature, some check signatories were not authorized and one check was missing any signature. It is recommended that the company comply with the existing board of directors' policy on check authorizations and signature requirements.

Examiners requested a copy of the company's procedures on the handling of the escheat checks and unclaimed funds reporting to the State of Wisconsin and was informed that

the company did not have a policy finished at this time. It is recommended that the company develop a written procedure for the handling of escheat checks and the reporting of unclaimed funds to the State of Wisconsin.

### **Disaster Recovery Plan**

The company has documentation relating to the steps necessary to restore its computers in the event of a disaster but the company has not developed a plan to address restoration and resumption of the functional portions of its operations. Having this documentation would facilitate the company's recovery from a disaster. In addition, it should be reviewed, updated and tested annually. It is recommended that the company create and maintain a disaster recovery plan which would be reviewed, updated, and tested annually.

### **Agent Licensing**

The company has seven agents appointed with this office's Agent Licensing section. It was noted during the examination that six of these agents are retired or no longer have associations with the company. It is recommended that the company comply with s. 628.11, Wis. Stat., and accurately report its agent appointments and terminations to this office.

### **Subsequent Events**

As a compromise settlement in the St. Croix County lawsuit, which alleged six years of improper jail procedures, it was agreed in 2004 that plaintiffs would receive \$6,965,000 as follows: \$70,000 between two named plaintiffs, \$5,500,000 to be divided equally among all final class members, and \$1,395,000 to counsel. It was determined that St. Croix County's retained portion of the settlement was \$2,447,000 (the aggregate retention for the years less other claim payments already applied against the deductible), with WMMIC responsible for the remaining \$4,518,000. However, in order to take advantage of lower administrative and issuance costs, the county issued \$7 million of revenue bonds and structured WMMIC's \$4,518,000 of note payments to coincide with the county's principal and interest payments on the bond issue. WMMIC recorded the \$4,518,000 as a paid loss for 2004 and established a note payable liability for that amount.

## **VIII. CONCLUSION**

As a result of the examination there was one adjustment to surplus and nine recommendations, which are listed in the next section captioned "Summary of Comments and Recommendations."

The company's financial position remains strong in relation to its written premium. Since the prior examination, the company's surplus has increased approximately \$2.9 million to a level of \$29.5 million, and the company has posted a positive net income before dividends to policyholders in each of the past five years. In the two years (2002 and 2003) that the company did have a net loss, it was because the company paid policyholder dividends and strengthened reserves due to some specific claims which settled in 2004.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 22 - Articles and Bylaws—It is again recommended that the company comply with s. 611.56 (1), Wis. Stat., in regards to committee appointments and, in addition, amend its bylaws to be consistent with the law.
2. Page 22 - Articles and Bylaws—It is recommended that the company comply with s. 611.12 (4), Wis. Stat., and file all Article and Bylaw amendments with the Commissioner within 60 days after adoption.
3. Page 23 - Self-Insured Retention Funds—It is recommended that WMMIC record the SIR assets, excluding WMMIC's portion of the checking account, and net of outstanding checks, as "Aggregate write-in for other than invested assets" with a corresponding amount reported under "Aggregate write-in for liabilities."
4. Page 24 - Reinsurance—It is recommended that the company properly report reinsurer account balances and information on its annual statement in accordance with NAIC Annual Statement Instructions – Property and Casualty.
5. Page 24 - Cash & Investments—It is recommended that the company comply with the existing Investment Policy or update and amend the policy to accurately reflect the current recommendations of the board of directors, and that a responsible officer review the investments for compliance with the policy.
6. Page 24 - Cash & Investments—It is recommended that the company comply with the existing board of directors' policy on check authorizations and signature requirements.
7. Page 25 - Cash & Investments—It is recommended that the company develop a written procedure for the handling of escheat checks and the reporting of unclaimed funds to the State of Wisconsin.
8. Page 25 - Disaster Recovery Plan—It is recommended that the company create and maintain a disaster recovery plan which would be reviewed, updated, and tested annually.
9. Page 25 - Agent Licensing—It is recommended that the company comply with s. 628.11, Wis. Stat., and accurately report its agent appointments and terminations to this office.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, Jerry DeArmond, Randy Milquet, and Carina Toselli of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Russell Lamb,  
Examiner-in-Charge